Supreme Court, U.S.
FILED
MAY 3 1996
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(3)

No. 95-1230

In the Supreme Court of the United States

OCTOBER TERM, 1995

BELLSOUTH TELECOMMUNICATIONS, INC., ET AL.,
PETITIONERS

v.

FEDERAL COMMUNICATIONS COMMISSION, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE FEDERAL RESPONDENTS IN OPPOSITION

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QUESTION PRESENTED

Whether the Federal Communications Commission (FCC) properly awarded damages to the customers of local exchange companies (LECs) for the LECs' violation of FCC orders prescribing the maximum rates of return that the LECs could earn.

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OPINION BELOW

The opinion of the court of appeals (Pet. App. 1a-26a) is reported at 59 F.3d 1407.

JURISDICTION

The judgment of the court of appeals was entered on August 1, 1995. Petitions for rehearing were denied on October 4, 1995. Pet. App. 120a-123a. The Chief Justice extended the time to file a petition for a writ of certiorari to, and including, February 1, 1996. The petition for a writ of certiorari was filed on that date. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. The Communications Act authorizes the Federal Communications Commission to ensure that the rates for interstate communications services provided by common carriers are just and reasonable. 47 U.S.C. 201(b). To carry out that duty, the Commission may, upon complaint, adjudicate the lawfulness of a carrier's rates for past periods. 47 U.S.C. 206-209. If the Commission determines that the complainant should be awarded damages, the agency "shall" order the carrier to pay the complainant the amount to which it is entitled. 47 U.S.C. 209.

In addition to its quasi-adjudicatory authority, the Commission has quasi-legislative authority, under which it may review the lawfulness of rates set forth in the tariffs by which common carriers generally implement rate changes. 47 U.S.C. 203. The Commission may reject a tariff if it is unlawful on its face. See, *e.g.*, *Capital Network Systems, Inc.* v. *FCC*, 28 F.3d 201 (D.C. Cir. 1994). The Commission also may investigate legally suspect rates and suspend those rates for up to five months pending the investigation. 47 U.S.C. 204(a) (Supp. V 1993). When the suspension period ends, the tariff revisions go into effect whether or not the Commission has completed its investigation. *Ibid.*[1] The Commission may, however, require the carrier to keep an accounting of its collections under the new rates and, at the end of the investigation, order the carrier to make refunds if the

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[1] In that event, the tariff binds the carrier and its customers, but its terms may be challenged in a complaint proceeding. See *Arizona Grocery Co.* v. *Atchison, T. & S.F. Ry.*, 284 U.S. 370, 384-385 (1932).

rates are not justified. 47 U.S.C. 204(a)(1) (Supp. V 1993).

After the carrier has an opportunity for a hearing, the Commission also may prescribe the just and reasonable rates or practices "to be thereafter observed" by the carrier. 47 U.S.C. 205. When the Commission does so, the carrier "shall not thereafter publish, demand, or collect any charge other than the charge so prescribed, or in excess of the maximum * * * so prescribed." 47 U.S.C. 205; see also 47 U.S.C. 408, 416; *Permian Basin Area Rate Cases*, 390 U.S. 747, 779 (1968).

In addition to prescribing rates and practices, the Commission may prescribe rates of return under Section 4(i) of the Act in conjunction with Section 205 of the Act. See *New England Telephone & Telegraph Co.* v. *FCC*, 826 F.2d 1101, 1106-1107 (D.C. Cir. 1987), cert. denied, 490 U.S. 1039 (1989); *Nader* v. *FCC*, 520 F.2d 182 (D.C. Cir. 1975).[2] The rate of return is "the amount of money a utility earns, over and above operating expenses, depreciation expenses, and taxes, expressed as a percentage of the legally established net valuation of utility property, the rate base." 2 P. Garfield & W. Lovejoy, *Public Utility Economics* 116 (1964). Earnings by a carrier that exceed the maximum set forth in a rate of return prescription are "unlawful and shall not occur." *New England Telephone*, 826 F.2d at 1106 (emphasis omitted).

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[2] Section 4(i) of the Act, 47 U.S.C. 154(i), provides:

> The Commission may perform any and all acts, make such rules and regulations, and issue such orders, not inconsistent with this chapter, as may be necessary in the execution of its function.

2. a. In 1984, the court of appeals in *New England Telephone* upheld the Commission's authority to enforce a rate of return prescription by requiring carriers to refund to their customers earnings that exceeded the prescribed maximum. 826 F.2d at 1106-1109. The court rejected the carriers' contention that the refund order constituted unlawful retroactive ratemaking. The court explained that refunds are an "absolutely necessary" means of enforcing an existing prescription order. 826 F.2d at 1108. The court upheld the Commission's authority to issue a refund order even if a carrier had acted in good faith in setting the rates that produced the excessive earnings. *Id.* at 1106.

b. In 1985, the Commission established rules for prescribing rates of return for the local exchange carriers (LECs) and procedures to enforce those prescriptions.[3] Under the rules, the Commission prescribed maximum returns for the LECs' overall interstate earnings and for three categories of access charge rate elements. *Rate of Return Reconsideration*, FCC 86-114, at 19 (¶ 37) (released Mar. 24, 1986); see 51 Fed. Reg. 11,033, 11,034 (1986) (summary of

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[3] *Authorized Rates of Return for the Interstate Services of AT&T Communications and Exchange Carriers*, FCC 85-527 (released Sept. 30, 1985), 50 Fed. Reg. 41,350 (*Rate of Return Order*), recon. granted in part, FCC 86-114 (released Mar. 24, 1986), summarized in, 51 Fed. Reg. 11,033 (Apr. 1, 1986) (*Rate of Return Reconsideration*), further recon. denied, 2 FCC Rcd 190 (1987), rev'd in part *sub. nom. American Telephone & Telegraph Co.* v. *FCC*, 836 F.2d 1386 (D.C. Cir. 1988) (*AT&T*); *Amendment of Part 65, Interstate Rate of Return Prescription: Procedures and Methodologies to Establish Reporting Requirements*, 1 FCC Rcd 952 (1986), recon. denied, 2 FCC Rcd 5340 (1987) (*Reporting Requirements Order*).

Commission Memorandum and Order). The Commission recognized that its review of earnings on a category-by-category basis might result in refunds of excessive earnings in some categories even though the LECs' return was not excessive overall. *Id.* at 18 (¶ 34). The Commission pointed out, however, that its duty under the Act to ensure just and reasonable rates required it "to prevent one class of customers from paying excessive rates or cross-subsidizing other customers." *Id.* at 9 (¶ 10); see Pet. App. 36a.

The Commission included safeguards to give the LECs an opportunity to achieve the prescribed rates of return. The Commission announced that it would not take remedial action unless a carrier's rate of return exceeded both the prescribed return and a specified "buffer." *Rate of Return Order*, FCC 85-527 (released Sept. 30, 1985); see 50 Fed. Reg. at 41,350-41,353 (¶¶ 4-22). The Commission also said that it would review the LECs' earnings levels only in three broad categories, and not on the basis of each rate element. *Rate of Return Reconsideration* at 18-19 (¶ 36). In addition, the Commission adopted a two-year monitoring period instead of the traditional one-year period. *Rate of Return Order*, 50 Fed. Reg. at 41,354 (¶ 24). The longer period decreased the possibility that temporary fluctuations in earnings levels would precipitate a violation, see *Virgin Islands Telephone Corp.* v. *FCC*, 989 F.2d 1231, 1233 (D.C. Cir. 1993), and increased the LECs' opportunity to file mid-course corrections to avoid deficiencies and over-earnings. See 50 Fed. Reg. at 41,354 (¶ 24).[4] To monitor the

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[4] "The term 'mid-course correction filing' generally refers to an LEC's proposed rate adjustment to account for actual costs experienced under rate-of-return regulation that deviate

LECs' compliance with the rate of return prescriptions and to give them an "early warning system" for the need to file mid-course corrections, the Commission required each LEC to file quarterly and biennial rate of return reports that set forth data on its overall rate of return and its rate of return for each service category. *Reporting Requirements Order*, 1 FCC Rcd 952 (1986), recon. denied, 2 FCC Rcd 5340 (1987); 47 C.F.R. 65.600(b).

The Commission adopted an automatic refund mechanism to enforce its rate of return prescriptions. Under that scheme, whenever the LEC exceeded a maximum prescription (for either the overall return or any of the three service category returns), the excess earnings automatically would have been returned to all affected ratepayers in the form of revenue requirement reductions in later periods. 50 Fed. Reg. at 41,353-41,355 (¶¶ 23-38).

c. On review, the court of appeals reaffirmed the Commission's authority to require carriers to return to their ratepayers earnings in excess of a rate of return prescription. *AT&T*, 836 F.2d at 1392 (citing *New England Telephone*). The court set aside the automatic refund rule, however, on the ground that it was inconsistent with prior Commission statements about the nature of its rate of return prescriptions. 836 F.2d at 1390. As the court understood those prior statements, the Commission viewed the rate of return prescription as establishing not only the maximum allowable level of earnings but also the minimum earnings necessary to cover the cost of capital. On

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from cost projections employed in initial rate-setting proceedings." *Southwestern Bell Telephone Co.* v. *FCC*, 10 F.3d 892, 893 n.1 (D.C. Cir. 1993).

the basis of that understanding, the court determined that a rule that automatically refunded to consumers excessive earnings every time that a carrier overearned, without ever taking into account underearnings, "would operate over the long run to put a carrier out of business." *Ibid.* The court distinguished such a remedial rule from the award of a refund for the violation of a rate of return prescription in "an individual case." *Id.* at 1392.

The Commission later clarified that a rate of return prescription does not establish the minimum earnings necessary to attract investment. *Represcribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers*, 5 FCC Rcd 7507, 7532 (¶ 217), recon. denied, 6 FCC Rcd 7195 (1991), aff'd *sub. nom. Illinois Bell Telephone Co.* v. *FCC*, 988 F.2d 1254 (D.C. Cir. 1993) (*1990 Prescription Order*). The Commission explained that a "substantial gap" exists "between an earnings level that is fully adequate to assure attraction of capital on favorable terms, and an earnings level which, if sustained over time, would be confiscatory." *Ibid.*[5]

3. This case began when customers of the LECs filed complaints with the Commission between 1989 and 1991 seeking damages on the ground that the rates they had paid for interstate access service had produced earnings for the LECs that exceeded the maximum rates of return prescribed by the Commission. *E.g.*, *MCI Telecommunications Corp.* v.

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[5] See also *Amendment of Parts 65 and 69 of the Commission's Rules to Reform the Interstate Rate of Return Represcription and Enforcement Processes*, 7 FCC Rcd 4688, 4701 (¶ 97) (1992) (a prescribed rate of return "is a point within a broad zone of reasonableness").

Cincinnati Bell Telephone Co., File No. E-90-423, MCI Complaint at 5 (filed Aug. 30, 1990).[6] The LECs argued that the complaints failed to state a claim for relief; they generally did not, however, dispute the customers' contention that the LECs' own rate of return monitoring reports showed that the LECs' interstate earnings overall or their earnings for one or more of the three interstate access categories exceeded the maximum rate of return prescriptions. See, *e.g.*, Pet. App. 37a-38a.

In a series of orders, the Commission held that the LECs were liable for damages to the customers. *E.g.*, Pet. App. 49a. The Commission determined that undisputed evidence in the LECs' own monitoring reports established that the LECs had violated the rate of return prescriptions. *E.g.*, *id.* at 30a, 49a-50a. The Commission also determined that those vio-

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[6] The rate of return prescriptions at issue in this case involve the 1985-1986 monitoring period (which extended from October 1, 1985, to December 31, 1986), the 1987-1988 monitoring period (which extended from January 1, 1987, to December 1, 1988), and the 1989-1990 monitoring period (which extended from January 1, 1989, to December 30, 1990). The prescribed rate of return for the interstate access services of the LECs during the 1987-1988 monitoring period was 12.75%. See *Rate of Return Order*, 50 Fed. Reg. at 41,350 (¶ 4). With the buffer, the maximum prescribed return was 13.10% overall and 13.25% for any service category. See, *e.g.*, Pet. App. 36a-37a. For the 1987-1988 and 1989-1990 monitoring periods, the Commission lowered the prescribed return to 12%, with a maximum allowable return of 12.25% on overall earnings and 12.40% for the service categories. *Authorized Rate of Return for the Interstate Services of AT&T and Exchange Telephone Carriers*, CC Docket No. 84-800, Phase III, 1986 WL 290922 (F.C.C.) (released Aug. 26, 1986), recon. denied, 2 FCC Rcd 5636 (1987).

lations constituted a violation of Section 201(b) of the Act. Pet. App. 49a-50a. The Commission explained that a rate of return prescription represents an agency determination that rates that produce earnings in excess of the maximum prescribed level are unjust and unreasonable, and therefore prohibited by Section 201(b). Pet. App. 84a n.29.

The Commission rejected the LECs' contention that, to recover damages, the customers not only had to prove that they had been injured by paying rates that produced unlawful rates of return but also had to establish what specific rates would have produced lawful rates of return. Pet. App. 101a-103a. The Commission pointed out that the LECs retain substantial flexibility both in setting their initial rates and in making midterm corrections. *Id.* at 60a-61a. The Commission reasoned that it would be unfair to permit the LECs, "who were in the best position to set their rates at lawful levels in the first place, and who later had opportunities to correct those rates, to avoid responsibility for those unlawful rates, at the expense of their customers." *Ibid.*

The Commission determined that the appropriate "starting point" for measuring damages was the difference between the amount that the customer actually had paid and the amount that it would have paid if the LEC had charged rates that produced earnings within the prescribed return. Pet. App. 101a. The Commission then offset that sum by the amount of underearnings the LEC had experienced in other access service categories that the customer had purchased during the same monitoring period. *E.g.*, *id.* at 107a-108a.

4. Both the LECs and the customers filed petitions for review of the Commission's orders in the United

States Court of Appeals for the District of Columbia Circuit. The court denied the LECs' petitions in their entirety. Pet. App. 7a-20a. In response to the customers' petitions, the court set aside the Commission's use of offsets in calculating damages. *Id.* at 20a-26a.

The court upheld the Commission's determination that the LECs had violated the Communications Act by earning more than the maximum prescribed rate of return, stating: "We have repeatedly held that a rate-of-return prescription has the force of law and that the Commission may therefore treat a violation of the prescription as a *per se* violation of the requirement of the Communications Act that a common carrier maintain 'just and reasonable' rates." Pet. App. 13a (citing *Nader* and *New England Telephone*); see *id.* at 12a-13a. The court rejected the LECs' reliance on the court's prior decision in *AT&T*. It explained that *AT&T* had held only that the Commission could not act in a manner inconsistent with its own understanding of its rate of return regulation. The court observed that the Commission had later clarified its understanding of a rate of return prescription, and the court determined in light of that clarification that there was no conflict between the damages awards in this case and the agency's regulatory policy. *Id.* at 7a-11a.

Although the court set aside the Commission's use of offsets (Pet. App. 20a-26a), it upheld "the Commission's general approach to damages," *id.* at 2a. In particular, the court agreed with the Commission that it was not necessary for the customers to specify what rates the LECs should have charged to produce a lawful rate of return. The court pointed out that it would be inequitable to require the complainant "from

the outside looking in" to formulate the lawful rate as a prerequisite to a damages award when the LEC itself "with its superior information" had been unable to do so. *Id.* at 16a. The court determined that the Commission had reasonably measured damages as the difference between the amount that the customers actually paid and the amount that they would have paid if the LEC had charged rates that would have produced lawful rates of return. *Id.* at 15a. The court also found it reasonable for the Commission to calculate that difference by multiplying the percentage amount by which the LEC's had overearned by the amount that the customers had actually paid. *Ibid.* The court found that the Commission's calculation produced a conservative estimate of damages. *Id.* at 17a.

ARGUMENT

Petitioners contend (Pet. 12-23) that a carrier may not be held liable in damages for violating the rates of return prescribed by the Federal Communications Commission. That contention does not present an issue of continuing significance, in light of the replacement of rate of return regulation by a "price caps" system of regulation for most of the telecommunications industry. Moreover, the court of appeals correctly upheld the Commission's determination of liability and, in relevant part, its approach to calculating damages.[7] The court of appeals' decision does not conflict with any decision of this Court or of any

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[7] Petitioners do not seek further review of the court of appeals' decision to set aside the Commission's use of offsets in calculating damages.

other court of appeals. Further review is therefore not warranted.

1. Most of the telecommunications industry, including most of petitioners, is no longer subject to rate of return regulation. In 1990, the Commission replaced that method of regulation with an incentive-based "price caps" method of regulation. *Policy and Rules Concerning Rates for Dominant Carriers*, 5 FCC Rcd 6786 (1990), recon. granted in part, 6 FCC Rcd 2637 (1991), aff'd *sub nom. National Rural Telecomm. Ass'n* v. *FCC*, 988 F.2d 174 (D.C. Cir 1993). Unlike rate of return regulation, which bases rates on the LECs' individual expenses plus a reasonable return on the rate base, the price caps system sets rate ceilings. This system gives LECs an incentive to reduce their costs by allowing them to retain higher levels of earnings achieved through such reductions. The system thus focuses on limiting the LECs' rates rather than their rates of return. 5 FCC Rcd at 6787.

The price caps system applies to most of the local exchange telecommunications industry. The system is mandatory for the Bell Operating Companies and affiliates of the GTE Corporation. Other LECs may elect to be regulated under the price caps system or to remain regulated under the rate of return system. 5 FCC Rcd at 6818-6819 (¶¶ 262-265); 6 FCC Rcd at 2699, 2703 (¶¶ 138, 145). During the 1993-1994 period (the latest period for which statistics are available), price caps companies had more than 90% of the local exchange interstate revenues, whereas companies

regulated under the rate of return method had less than 10%.[8]

The advent of the price caps system renders the question presented of little continuing importance. LECs subject to price caps regulation are not liable for damages on the ground that their earnings exceed a maximum prescribed rate of return. Moreover, any LEC regulated by the rate of return method can avoid prospective liability for such damages awards by converting to the price caps system.

2. a. The court of appeals correctly upheld the Commission's determination that the customers established liability under Section 206 of the Act by proving that the LECs violated the rate of return prescriptions. See Pet. App. 11a-13a, 49a-51a, 103a.[9] When a carrier violates a prescriptive order of the Commission, it violates the Communications Act itself. Section 205(a) not only authorizes the Commission to issue prescriptive orders but also directs carriers to "conform to and observe the regulation or

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[8] These statistics were compiled by the Industry Analysis Division of the Commission's Common Carrier Bureau using the FCC Form 492 rate of return monitoring reports filed by non-price caps companies for the January 1, 1993-December 31, 1994 monitoring period and the Form 492a rate of return reports for 1993 and 1994 filed by price caps companies.

[9] 47 U.S.C. 206 provides in relevant part:

> In case any common carrier shall do, or cause or permit to be done, any act, matter, or thing in this chapter prohibited or declared to be unlawful, or shall omit to do any act, matter, or thing in this chapter required to be done, such common carrier shall be liable to the person or persons injured thereby for the full amount of damages sustained in consequence of any such violation of the provisions of this chapter * * *.

practice so prescribed." 47 U.S.C. 205(a); see also 47 U.S.C. 416 (carriers have "duty" to "observe and comply with [Commission] orders so long as the same shall remain in effect"). Commission prescriptions have "the force of a statute" to which carriers are "bound to conform." *Arizona Grocery Co.*, 284 U.S. 370, 386 (1931); accord *New England Telephone*, 826 F.2d at 1107; Pet. App. 13a. Although an agency prescription is not itself "a 'provision' of the statute," Pet. 13, the violation of such a prescription *is* an act that under Section 205(a) is "prohibited or declared to be unlawful." 47 U.S.C. 206. Thus, the text of the Act forecloses petitioners' contention (Pet. 12-14) that their admitted violations of the rate of return prescriptions did not violate the statute.

The court of appeals also correctly upheld the Commission's determination that, by charging rates that produced earnings in excess of the maximum rate of return, the LECs violated the requirement in Section 201(b) of the Act that rates be "just and reasonable." Pet. App. 12a-13a, 84a n.29.[10] The Commission has used rate of return prescriptions for many years to carry out its statutory responsibility to assure that the rates of common carriers are just and reasonable. See *Nader* v. *FCC*, 520 F.2d 182, 204

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[10] 47 U.S.C. 201(b) provides in relevant part:

> All charges, practices, classifications, and regulations for and in connection with such communication service, shall be just and reasonable, and any such charge, practice, classification, or regulation that is unjust or unreasonable is declared to be unlawful * * *. The Commission may prescribe such rules and regulations as may be necessary in the public interest to carry out the provisions of this chapter.

(D.C. Cir. 1975).[11] Such a prescription reflects the Commission's finding that the prescribed level is the "just and reasonable * * * maximum," 47 U.S.C. 205(a), and that earnings in excess of that maximum level "are unlawful," *New England Telephone*, 826 F.2d at 1106 (emphasis omitted).[12] Indeed, such a finding is an "essential" prerequisite to the Commission's exercise of its prescriptive authority under Section 205(a). *American Telephone & Telegraph Co.* v. *FCC*, 449 F.2d 439, 450 (2d Cir. 1971); see also *American Telephone & Telegraph Co.* v. *FCC*, 487 F.2d 865, 874 (2d Cir. 1973). In those circumstances, the only way that the carriers can realize earnings above the rate of return prescription is by charging rates that are unjust and unreasonable, and that therefore violate Section 201(b).

This Court has held that, when an agency has issued a prescription, it "may not in a subsequent proceeding, acting in its quasi-judicial capacity, ignore its own pronouncement promulgated in its quasi-legislative capacity and retroactively repeal its own enactment." *Arizona Grocery Co.*, 284 U.S. at 389. As discussed above, the Commission decided at the time it issued the prescription that cumulative rates that produce earnings above the maximum prescribed level were unlawful. The Commission

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[11] See also *New England Telephone*, 826 F.2d at 1106 (Commission's "chief concern in issuing [a rate of return] prescription is protecting just and reasonable rates"); *United States* v. *FCC*, 707 F.2d 610, 612 (D.C. Cir. 1983).

[12] See *MCI Telecommunications Corp.* v. *FCC*, 712 F.2d 517, 537 (D.C. Cir. 1983); *American Telephone & Telegraph Co.* v. *FCC*, 572 F.2d 17, 22 (2d Cir. 1977), cert. denied, 439 U.S. 875 (1978); *Nader*, 520 F.2d at 199.

properly gave preclusive effect to that decision in the adjudicatory proceedings that gave rise to this case.

b. Even apart from the Commission's obligation to give effect to its rate of return prescriptions in adjudicating complaints, the court of appeals correctly determined that it was reasonable for the Commission to conclude that utility rates that yield excessive earnings are unlawful. Decisions of this Court make clear that an agency may reasonably infer that excessive earnings are the result of excessive rates.

In *FPC* v. *Tennessee Gas Transmission Co.*, 371 U.S. 145 (1972), this Court upheld an interim order in which the Federal Power Commission (FPC) had prescribed a rate of return and had ordered a natural gas company to refund to its customers amounts above the prescribed level. The Court held that the FPC could order refunds solely on the basis that the carrier's overall earnings were excessive. The Court explained that, when the rate of return is excessive, "the revised over-all rate [is] * * * to that extent unlawful." *Id.* at 153.

The Court had reached a similar conclusion in *Dayton-Goose Creek Ry.* v. *United States*, 263 U.S. 456 (1924). The Court there upheld the constitutionality of the Transportation Act of 1920, which required the Interstate Commerce Commission (ICC) to prescribe both uniform rates and an aggregate reasonable rate of return. See *Dayton-Goose Creek Ry.*, 263 U.S. at 476-479. If a carrier's overall earnings exceeded the prescribed rate of return, the Act directed the carrier to put one-half of the excess amount into a reserve fund to be used by that carrier for certain specified uses, and the other half into a revolving fund administered by the ICC for the

benefit of carriers earning less than the prescribed rate of return. 263 U.S. at 476-477. In upholding the statutory provision requiring the "recapture" of earnings above the prescribed return, the Court held that a carrier's rate of return provided a reasonable standard for gauging the reasonableness of the overall rates. The Court explained:

> It is clearly unsound to say that the net operating profit accruing from a whole rate structure is not relevant evidence in determining whether the sum of the rates is fair. The investment is made on the faith of a profit, the profit accrues from the balance left after deducting expenses from the product of the rates, and the assumption is that the operation is economical and the expenditures are reasonably necessary. *If the profit is fair, the sum of the rates is so. If the profit is excessive, the sum of the rates is so.*

263 U.S. at 483 (emphasis added). Thus, contrary to petitioners' contention (Pet. 15-16), *Dayton-Goose Creek Ry.* supports, rather than undermines, the decision below.[13]

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[13] In *Dayton-Goose Creek Ry.*, the railroad had argued in the alternative that, if it had no right to the earnings in excess of the prescribed return, those earnings rightfully belonged to the shippers, rather than to the government. The Court held that the railroad had no standing to make that argument. See 263 U.S. at 484. The Court also stated that the shippers had no right to the excess because the uniform rates "are reasonable from the standpoint of the shipper." *Ibid.* The Court determined that the rates were reasonable from the shipper's standpoint, even if they produced an excessive rate of return for the carrier, because the excess was used in a manner that benefited shippers; it was put into a reserve fund that was used to ensure the integrity of the rail system as a whole, by, for

Petitioners' reliance (Pet. 16) on *FPC* v. *Natural Gas Pipeline Co.*, 315 U.S. 575 (1942), is also unavailing. In that case, the Court upheld an order in which the FPC had found that the carriers' rates were unlawful because they produced excessive earnings, *id.* at 580, and as a remedial matter had ordered the carriers "to file a new rate schedule which would result in the prescribed reduction in operating revenues," *id.* at 583. The Court held that the FPC had discretion to leave to the carriers in the first instance the task of formulating lawful rates to replace the rates that it had "found to be unjust and unreasonable." *Id.* at 585. Thus, in *FPC* v. *Natural Gas Pipeline Co, supra,* as in *FPC* v. *Tennessee Gas Transmission Co., supra,* the Court recognized that it is reasonable for an agency to find that excessive earnings result from excessive—*i.e.*, "unjust and unreasonable"—rates.

c. Petitioners also contend that the D.C. Circuit departed from its own precedent in upholding the Commission's determination that rates that yield earnings in violation of a rate of return prescription are per se unlawful. Any such intracircuit conflict is for that court to resolve. See *Wisniewski* v. *United States*, 353 U.S. 901, 902 (1957) (per curiam). In any event, there is no conflict.

As the court of appeals explained (Pet. App. 12a-13a), its decision in this case followed logically from its decisions in *Nader*, which upheld the Commission's authority to adopt binding rate of return

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example, supporting underearning carriers in the region. *Id.* at 480. The Court's determination is inapposite here, because an LEC's excessive earnings are not put into a reserve fund that is used in a manner that benefits the LEC's customers.

prescriptions, and *New England Telephone*, which upheld the Commission's authority to enforce such prescriptions by refunding to the customers earnings in excess of the prescribed return. See also *Potomac Elec. Power Co.* v. *Public Utilities Comm'n of D.C.*, 158 F.2d 521, 523 (D.C. Cir.), (when the rate of return is excessive, "it follows as a matter of law" that the rates, "instead of being 'just and reasonable' as the law requires them to be, have been excessive"), cert. denied, 331 U.S. 816 (1946).[14]

As the court also explained (Pet. App. 10a-11a, 13a-14a), its decision does not conflict with *Virgin Islands Telephone Corp.* v. *FCC*, 989 F.2d 1231 (D.C. Cir. 1993). The court in *Virgin Islands Telephone* held that the Commission erred in finding that a carrier had violated the rate of return prescription. *Id.* at 1237-1240. The court therefore did not have to determine whether refunds would have been permissible if such a violation had occurred. Although the court did cite some factors that, in its view, would have been relevant in determining a refund order for a violation of a rate of return prescription, its discussion of those factors was dicta. *Id.* at 1239-1240. Moreover, as the court of appeals explained in this case (Pet. App. 13a-14a), the factors cited in *Virgin Islands Telephone* were ones that the court thought relevant to the Commission's exercise of its discretion to order a refund in carrying out its equitable rate-making authority under Section 204 of the Act;

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[14] In asserting a conflict with *Nader*, petitioners rely (Pet. 16) on the statement in that case that a rate of return is not the equivalent of a rate. *Nader*, 520 F.2d at 201. The court of appeals in this case, however, likewise recognized the distinction. See, *e.g.*, Pet. App. 3a, 13a.

those factors "do not apply where, as here, the Commission is adjudicating a damage claim made by a customer pursuant to § 206." Pet. App. 14a; see also *Baer Bros.* v. *Denver & Rio Grande R.R.*, 233 U.S. 479, 486 (1914).[15]

e. Petitioners contend (Pet. 20) that the decision below exposes carriers to liability for events beyond their control. The Commission's rate of return prescriptions, however, give the LECs substantial flexibility in formulating rates and rate structures for individual services. See Pet. App. 61a; 47 U.S.C. 203; *Nader*, 520 F.2d at 201.[16] Moreover, if a carrier's initial rates are not properly targeted to achieve the prescribed rate of return, or if market or cost changes threaten to cause a departure from the prescribed return, the LEC may file mid-course corrections to avoid excessive, as well as deficient, levels of earnings. See Pet. App. 16a, 61a; *New England Tele-phone*, 826 F.2d at 1109. Furthermore, the Commission has facilitated a carrier's ability to avoid violations and to earn the maximum prescribed rate of return by the adoption of "buffer[s]," Pet. App. 16a; *New England Telephone*, 826 F.2d at 1109, and a two-

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[15] Compare 47 U.S.C. 204 (Supp. V 1993) (Commission "may" require refunds in certain circumstances) with 47 U.S.C. 209 (if Commission "determines[s] that any party complainant is entitled to an award of damages," it "shall" order carrier to pay complainant the sum to which it is entitled).

[16] As long as an LEC complies with the rate of return prescription, the LEC cannot be liable for damages even if the cost of capital drops so much that the prescribed return is excessive by all economic measures. See *New England Telephone*, 826 F.2d at 1109.

year monitoring period, see *Virgin Islands Telephone*, 989 F.2d at 1233.[17]

Petitioners err in suggesting (Pet. 13 n.8, 22) that they cannot be liable in damages for violating a rate of return prescription unless the violation was intentional or negligent. Section 206 provides that a carrier "shall be liable" to those injured by its unlawful acts "for the full amount of damages." 47 U.S.C. 206. Thus, the Act does not require a showing of deliberate or negligent conduct. *New England Telephone*, 826 F.2d at 1106. The purpose of an award of damages, moreover, is not punitive; it merely requires the carriers "to give up what they never should have collected in light of the rate of return prescription." *Id.* at 1108.

Likewise without merit is petitioners' contention that they should not be liable in damages "without any opportunity to recover their underearnings in other categories or in their overall operations." Pet. 22. The LECs are not exempt from liability for charging excessively high rates for certain categories of service simply because other rates are low or because their overall earnings are not excessive. See Pet. App. 59a-60a. As this Court has explained, a regulated utility bears both the risk of losses for the

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[17] Petitioners are wide of the mark in citing (Pet. 21 n.10) *Virgin Islands Telephone* as a "particularly glaring illustration" of an LEC's inability to avoid liability for overearnings beyond its control. In that case, although the carrier's earnings increased greatly during the first six months after Hurricane Hugo, the court of appeals held that the LEC had not violated the rate of return prescription because compliance with the rate of return should be measured over the entire two-year monitoring period, and not over only a portion of that period. *Virgin Islands Telephone*, 989 F.2d at 1237-1240.

services it underprices and the prospect of refunding amounts gained through rates that are unreasonably high. *Tennessee Gas*, 371 U.S. at 152-153.

Petitioners suggest that imposing damages liability for rate of return violations "denies carriers the rate stability built into the Communications Act" by making them "retroactively liable" for charging their filed rates. Pet. 22-23. It is well-established, however, that the filed rate is not necessarily the lawful rate. See *Maislin Indus.* v. *Primary Steel, Inc.*, 497 U.S. 116, 128-129 (1990); *Arizona Grocery*, 284 U.S. at 384. As the LECs acknowledge, Pet. 20, the customer may contest a filed rate in a complaint action and recover damages if it shows that the rate is unjust and unreasonable. 47 U.S.C. 206-209; see *Arizona Grocery*, 284 U.S. at 384.[18] In short, liability for damages arising from filed rates that violate the Act is an established part of the statutory framework.[19]

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[18] Although petitioners rely (Pet. 7) on the concurring opinion in *AT&T*, 836 F.2d at 1393, the relief awarded by the Commission in this case comports with that opinion's description of the Commission's adjudicatory authority to award damages to private parties under Sections 206-209 as a means "through which an aggrieved customer can obtain relief" for paying rates that yield earnings above the prescribed return. 836 F.2d at 1394 (Starr, J., concurring).

[19] It does not matter, contrary to petitioner's suggestion (Pet. 11), that the challenged rates were not suspended before they went into effect. Although the court of appeals has held that the suspension of rates is a condition precedent to the Commission's authority to order refunds as part of its discretionary ratemaking authority under Section 204, see *Illinois Bell Telephone Co.* v. *FCC*, 966 F.2d 1478 (D.C. Cir. 1992), it is not a condition to the Commission's exercise of its adjudicatory responsibilities under Sections 206-209.

3. The court of appeals correctly upheld the "Commission's general approach to damages." Pet. App. 2a. The Commission identified the initial, (*i.e.* pre-offset) measure of damages as "the difference between the charges paid and the just and reasonable rate." *Id.* at 15a, 101a. The Commission reasonably decided to calculate that difference by determining the difference between the actual and prescribed rate of return and then multiplying that percentage difference by the amount that the customer paid for the service. *Ibid.*

As the court of appeals correctly held (Pet. App. 14a-15a), the Commission's approach was not foreclosed by the case law on which petitioners have relied, such as *Reiter* v. *Cooper*, 507 U.S. 258 (1993); *Meeker* v. *Lehigh Valley R.R.*, 236 U.S. 412 (1915); and *United States* v. *Associated Transport, Inc.*, 505 F.2d 366 (D.C. Cir. 1974). See Pet. 18. None of those cases involved a violation of a rate of return prescription. Thus, they did not consider whether an agency, in calculating damages for such a violation, could "make a simplifying assumption about what the reasonable rate would have been." Pet. App. 15a.

The court of appeals also correctly determined that the Commission's calculation of damages was fair to both carriers and their customers. As the court explained, the LECs themselves had been unable to establish a precise "reasonable" rate, even with superior information on their own costs and expenses. Thus, it would have been inequitable to require the customer, "from the outside looking in," to perform the task that the LEC itself had been unable to do. Pet. App. 16a. Moreover, as the court correctly observed, the Commission's approach led to a conserva-

tive estimate of damages because it assumed that demand is price-inelastic. *Id.* at 17a.[20]

Although the court's economic analysis is amply supported by expert authority, see Pet. App. 16a-17a, petitioners challenge the court's underlying assumption that a rate reduction by the LECs would have resulted in a reduction in the LECs' earnings. Petitioners speculate that a rate reduction might have increased their earnings, and thus the complaining customers "may have been *under*charged rather than *over*charged." Pet. 19. Petitioners' speculation conflicts with this Court's recognition that an agency may reasonably infer that excessive earnings are the result of excessive rates. See *Tennessee Gas*, 371 U.S. at 152-153; *Dayton-Goose Creek Ry.*, 263 U.S. at

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[20] The court of appeals explained that the formulation of a rate that would produce lawful earnings necessarily is an estimate, because the effect that any rate or rate change will have upon the LECs' revenues (and thus their rate of return) depends upon a factor that cannot be known for certain: the level of demand. Pet. App. 17a. The court noted that, in calculating the amount of damages that they sought to recover, the customers had assumed that demand is not price elastic—*i.e.*, holding cost and demand constant, they assumed that a reduction in rates would produce a proportionate reduction in revenues. The court found that this assumption yielded a conservative estimate of damages, because using a price elastic model would have resulted in a higher damages calculation. The court reasoned that, if a price reduction increases demand (and increases the amount of service procured), any reduction in revenues associated with the reduction in price would be less than proportionate. Because the "reasonable" rate in this type of case has to be an estimate, and in light of that fact that the estimate used by the complainants produced lower damages than the alternative price elastic approach, the court upheld the Commission's determination that the complainants had sustained their burden of proving damages. *Ibid.*

483; see also *Potomac Elec. Power Co.* v. *Public Utilities Comm'n*, 158 F.2d at 523. In any event, even if it were assumed that petitioners' theory is correct, it would not show that the customers had been undercharged. A rate of return prescription does not require the LECs, when they charge rates that produce earnings above the prescribed ceiling, to exacerbate the violation by reducing their rates to a level which produces even greater earnings (if such a hypothetical level were indeed attainable). Rather, the LECs are required to reduce their rates to a level that produces earnings at or below the prescribed ceiling. If the rate reduction were large enough, it ultimately would reduce the LECs' earnings to a lawful level, under any plausible set of economic assumptions. Pet. App. 16a-17a.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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MAY 1996